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Counsel for the Official Committee Of  
Equity Security Holders Of USA Capital First Trust Deed Fund, LLC

**UNITED STATES BANKRUPTCY COURT  
DISTRICT OF NEVADA**

In re: ) BK-S-06-10725-LBR  
USA COMMERCIAL MORTGAGE COMPANY ) Chapter 11  
Debtor )

In re: ) BK-S-06-10726-LBR  
USA CAPITAL REALTY ADVISORS, LLC, ) Chapter 11  
Debtor )

In re: ) BK-S-06-10727-LBR  
USA CAPITAL DIVERSIFIED TRUST DEED FUND, LLC, ) Chapter 11  
Debtor )

In re: ) BK-S-06-10728-LBR  
USA CAPITAL FIRST TRUST DEED FUND, LLC, ) Chapter 11  
Debtor. )

In re: ) BK-S-06-10729-LBR  
USA SECURITIES, LLC, ) Chapter 11  
Debtor. )

Affects )  
☒ All Debtors )  
☐ USA Commercial Mortgage Co. )  
☐ USA Securities, LLC ) Date: June 21, 2006  
☐ USA Capital Realty Advisors, LLC ) Time: 9:30 a.m.  
☐ USA Capital Diversified Trust Deed ) Place: Courtroom #1  
☐ USA First Trust Deed Fund, LLC )

**OPPOSITION TO MOTION FOR EMERGENCY, INTERIM AND PERMANENT  
ORDERS AUTHORIZING THE DEBTORS TO OBTAIN POST PETITION  
FINANCING (AFFECTS ALL DEBTORS)**

1 **TO THE HONORABLE LINDA B. RIEGLE, UNITED STATES BANKRUPTCY**  
2 **JUDGE:**

3 The Official Committee of Equity Security Holders of USA Capital First Trust  
4 Deed Fund, LLC (the "First Trust Deed Committee"), by and through its undersigned counsel,  
5 hereby opposes the Motion for Emergency, Interim and Permanent Orders Authorizing the  
6 Debtors to Obtain Post Petition Financing (the "Financing Motion") filed by USA Commercial  
7 Mortgage Company ("USACMC"), on behalf of itself and its affiliated debtors (each, a  
8 "Debtor" and, collectively, the "Debtors").

9 This Opposition is made and based upon the Points and Authorities attached  
10 hereto, the pleadings, papers and records on file in this action, and any evidence and oral  
11 argument to be considered at the time of the hearing of the Financing Motion.

12 DATED this 19th day of June, 2006.

13 \_\_\_\_\_  
14 /s/ Eve H. Karasik

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OF USA CAPITAL FIRST TRUST DEED FUND,  
LLC

**POINTS AND AUTHORITIES**

**I. FACTUAL BACKGROUND**

1. On May 10, 2006, the Office of the United States Trustee appointed the First Trust Deed Committee. The First Trust Deed Committee represents the interests of the Equity Holders of USA Capital First Trust Deed Fund, LLC ("First Trust Deed Fund").

2. On May 18, 2006, this Court considered and denied the Debtors' Motion to Approve Due Diligence expenses in connection with a proposed debtor in possession financing from lender Fortress Capital.

3. In addition, this Court has cautioned Debtors' counsel on numerous occasions regarding the pitfalls of *de facto* substantive consolidation. On the first day of the case, the Court directed the Debtors' professionals to record charges in such a way as to track charges appropriate to each estate. Numerous reminders of this requirement have been given, including statements by the Court, the Office of the United States Trustee and counsel for the First Trust Deed Committee.

4. The Debtors have filed two budgets in support of their motion for use of cash collateral set for hearing on June 21. The revised 13-week Cash Flow Forecast (the "Amended Forecast") demonstrates that the Debtors have sufficient funds from servicing and other fees to operate the Debtors for the requested period through the end of July.<sup>1</sup>

5. On June 9, the Debtors filed the Financing Motion with the attached Term Sheet with Capital Source, which was the first time that the First Trust Deed Committee was apprised of the Term Sheet. The First Trust Deed Committee is informed and believes that the Debtors are negotiating an amended Term Sheet with another lender at this time. However, the First Trust Deed Committee has not yet received a copy of the new Term Sheet. The First Trust Deed Committee has raised its concerns with the Capital Source Term Sheet with the Debtors on several occasions in person, via telephone and through detailed emails. As of the

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<sup>1</sup> The Debtors shared a further amended forecast on June 16, 2006. Per the further Amended Forecast the Debtors have nearly \$600K in cash at the close of July 2006.

1 date of this email, the Debtors have not definitively responded to these concerns. Furthermore,  
2 no loan documents have been filed with the Debtors as of the date of this Opposition.

## 3 4 II. LEGAL ARGUMENT

### 5 A. Legal Standard.

6 6. In considering a post-petition financing transaction under Bankruptcy  
7 Code section 364, "the court acts in its informed discretion." See 11 U.S.C. §§ 364 (b) and (c)  
8 ("may authorize . . . "). The movant bears the burden of satisfying the requirements of  
9 Bankruptcy Code section 364. See In re Mosello, 195 B.R. 277 (Bankr. S.D.N.Y. 1996); RTC  
10 v. Swedeland Dev. Group, Inc. (In re Swedeland Dev. Group, Inc.), 16 F.3d 552, 564 (3rd Cir.  
11 1994). In addition to satisfying the express requirements of Bankruptcy Code section 364(c)  
12 ("no other financing available" and "adequate protection"), most courts require the debtor to  
13 demonstrate that the requested lending decision is "an exercise of its basic business judgment  
14 consistent with their fiduciary duties." See e.g. In re Ames Department Store, Inc., 115 B.R. 34,  
15 38 (Bankr. S.D.N.Y. 1990); In re LTV Steel Company, Inc., 201 W.L. 1822360, \*3 (N.D. Ohio  
16 2001).

17 7. Further, the statutory requirements for a request for financing secured by  
18 a senior or equal lien pursuant to §364(d) are even more stringent. The debtor may obtain credit  
19 or incur debt "secured by a senior or equal lien on property of the estate that is subject to a lien  
20 only if—

21 (A) the trustee if unable to obtain such credit otherwise; and

22 (B) there is adequate protection of the interest of the holder of the lien on  
23 the property of the estate on which such senior or equal lien is proposed to be granted.  
24 Furthermore, "the trustee has the burden of proof on the issue of adequate protection." 11.  
25 U.S.C. § 364(d)(2).

26 8. As set forth below, the Debtors have failed to satisfy the requisite  
27 statutory requirements necessary to obtain the DIP Financing requested pursuant to the  
28 Financing Motion.

**B. The Court Should Not Approve the Proposed DIP Financing under Bankruptcy Code Section 364**

9. The Debtors set forth the three part test that must be satisfied in order for a debtor to obtain debtor in possession financing under section 364(c) of the Bankruptcy Code: (1) the debtor must be unable to obtain unsecured credit under section 364(b)(1) by allowing a lender only an administrative claim; (ii) the credit transaction must be necessary to preserve the assets of the estates; and (iii) the terms of the transaction must be fair and reasonable, given the circumstances of the debtor and the proposed lender.<sup>2</sup> See Financing Motion at page 10. The Debtors have failed to submit any evidence in support of the Financing Motion, including the evidence necessary to satisfy the three part test. Further, for the reasons described below, the Proposed DIP Financing is not in the best interests of the First Trust Deed Fund, and the Debtors have failed to demonstrate that the Proposed DIP Financing is a necessity for these estates.

**1. The Proposed DIP Financing is Not in the Best Interest of USA Capital First Trust Deed Fund, LLC as it Would Unfairly Shift the Administrative Burden of the Reorganization**

10. As the Court is keenly aware, significant issues have been raised in the USACMC case with regard to what constitutes "property of the estate." Absent judicial determination to the contrary, it currently appears that the proceeds of outstanding loans as to which USACMC is the servicing agent may not, by and large, constitute property of the estate. Rather, ownership of these funds may be vested in the various lenders, comprised mainly of

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<sup>2</sup> In the Financing Motion and even though the "Collateral Security" includes a "priming lien", the Debtors provide that they do not believe that the proposed \$15 million financing will require approval under section 364(d) of the Bankruptcy Code and accordingly do not discuss that section in this context. Financing Motion, page 12. To the extent priming is required, the Debtors have not demonstrated that they have satisfied the requirements of section 364(d) of the Bankruptcy Code set forth above and as addressed, in part, below in the context of providing additional funding to existing borrowers.

1 direct lenders, and the two funds, First Trust Deed Fund, LLC and USA Capital Diversified  
2 Trust Deed Fund, LLC ("Diversified Trust Deed Fund", and collectively, the "Funds").

3 11. However, the Debtors propose a joint borrowing under \$15 million credit  
4 line as to which each of the Debtors would pledge all of their respective assets (see page 7,  
5 paragraph h, the Financing Motion) in order to secure advances made which "will be used to  
6 pay (i) operating expenses, limited capital expenditures and other amounts for general,  
7 corporate and ordinary course purposes of Borrower<sup>3</sup> as approved by Lender and (ii) such other  
8 administrative expenses as may be authorized under the Financing Order, including ongoing  
9 administrative expenses associated with the chapter 11 case of Borrower (the "Bankruptcy  
10 Case") pending in the United States Bankruptcy Court for the District of Nevada...". See  
11 Exhibit A to Financing Motion, at page 1.

12 12. The impact of such proposal would be to unfairly place upon the First  
13 Trust Deed Fund estate the burden of repaying monies utilized for operations and administrative  
14 expenses by all Debtors, particularly USACMC. This is especially inequitable in that First  
15 Trust Deed Fund, as a lender under various deeds of trust, already pays a servicing fee of at least  
16 1% to USACMC. In addition, although Debtors have not yet moved for assumption or rejection  
17 of any executory contracts, there is an operating agreement contract between First Trust Deed  
18 Fund and Debtor USA Capital Realty Advisors, LLC, whereby an additional 1% fee is  
19 purportedly charged for "management" of the First Trust Deed Fund.<sup>4</sup>

20 13. The effect of the proposed financing would be to create a prohibited *de*  
21 *facto* substantive consolidation of the case, at least for administrative claims purposes. For  
22 example, monies utilized to fund administrative expenses in the USACMC case *via* the  
23 proposed line of credit would be then owed by, and repayable from all assets of, the First Trust  
24

25  
26 <sup>3</sup> All five Debtors are referred to collectively as "Borrower."

27 <sup>4</sup> In the context of the case, it is unclear what "management" services are being provided,  
28 above and beyond the services provided by USACMC on behalf of all lenders.



1 Deed Fund. This is particularly egregious in that, while the First Trust Deed Fund appears to be  
 2 a solvent entity, the other Debtors appear to be insolvent or are less solvent. No grounds for  
 3 such substantive consolidation have been demonstrated.

4 14. "Because of the dangers in forcing creditors of one debtor to share on a  
 5 parity with creditors of a less solvent debtor [courts] have stressed that substantive  
 6 consolidation 'is no mere instrument of procedural convenience...but a measure vitally affecting  
 7 substantive rights.'" In re Augie/Restivo Baking Co. Ltd., 860 F.2d 515, 518, quoting In re  
 8 Flora Mir Candy Corp. v. R.S. Dickson & Co., 432 F.2d 1060, 1062 (2d Cir. 1970); Chemical  
 9 Bank New York Trust Co. v. Kheel, 369 F.2d 845, 847 (2d Cir. 1966). Accord, In re Crown  
 10 Mach & Welding, Inc., 100 B.R. 25, 27 (Bankr. D. Mont. 1989), quoting Flora Mir, 432 F.2d at  
 11 1062; Chemical Bank 369 F.2d at 847. "In the final analysis the main requirement for  
 12 substantive consolidation is that the rights of no creditor or interested party be prejudiced." In  
 13 re Stevenson, 153 B.R. 52, 53-54 (Bankr. D. Ohio 1993).

14 15. The Debtors' proposal would inequitably transfer separate administration  
 15 expenses of each Debtor into secured first priority debt upon which all Debtors are jointly  
 16 liable. Such result is neither appropriate nor equitable. It appears that Debtors' professionals,  
 17 faced with potential administrative shortfalls, wish to "hedge their bets" in order to increase the  
 18 pool of assets available to pay such expenses. The burden of such a shift would fall  
 19 disproportionately upon the Funds whose assets are property of their respective estates, if the  
 20 Direct Lenders are successful in asserting that their loan repayments are not payment of the  
 21 estate.<sup>5</sup>

22  
 23 <sup>5</sup> The following pleadings contain assertions by the Direct Lenders that post-petition  
 24 payments made by borrowers on account of Direct Lender loans are not property of the  
 25 estate: Direct Lenders' Motions...to Compel Debtor to Continue to Forward Lender  
 26 Payments to Direct Lenders, (Chubb, Docket #215); Opposition to Debtor's Motion to  
 27 Temporarily Hold Funds Pending a Determination of The Proper Recipients (Lepome,  
 28 Docket # 281); Limited Opposition to Motion to Temporarily Hold Funds (Corison, Docket  
 # 285); Motion to Direct Payments to Direct Lenders (Mcknight, Docket # 323); Opposition  
 to Debtor's Motion to Temporarily Hold Funds (Canepa Group, Docket # 345); Kiven's  
 Opposition to Debtors' Motion to Temporarily Hold Funds (Docket # 366); Direct Lenders'  
 Opposition to Debtors' Motion to Temporarily Hold Funds (Chubb, Docket # 377);

1                   16.     Procedurally, the Court should not consider a matter which would  
 2     effectuate substantive consolidation absent notice of both scope and content as is reasonably  
 3     likely to reach the affected constituents and reasonably inform the recipients of the nature of the  
 4     proceeding. Drabkin v. Midland-Ross Corp. (In re Auto-Train Corp.), 810 F.2d 270, 278 (D.C.  
 5     Cir. 1987). One of the defects found in that case was that individual notice to each of the  
 6     creditors by mail was not given. Id. at 279. In this case, the detrimental effect of pledging the  
 7     assets of each estate for the operational and bankruptcy reorganization expenses of the others is  
 8     likely to cause harm to each of the creditors of the more solvent estates. However, as reflected  
 9     by the Financing Motion at page 9, the Financing Motion was served upon the Limited Notice  
 10    List, with the Debtors contemplating the "final hearing" to be served on the entire Master  
 11    Service List.<sup>6</sup>

12                   **2.     The Debtors Have Not Demonstrated the Necessity Of The Proposed**  
 13                   **Borrowing For Payment Of Operational And Administrative Expenses**

14                   17.     The fundamental problem with the Debtors' request for financing is the  
 15     failure to tie the request to specific needs of specific Debtors. This is illustrated by a review of  
 16     the Debtors' description of the purposes of the Financing Motion as well as other pleadings on  
 17     file, and testimony provided by the Debtors at previous hearings. Paragraph 21 of the  
 18     Financing Motion sets forth a purported justification for approval of the proposed financing.  
 19     Five business uses of the funds are set forth. Three of them-referenced as (a), (b) and (e),  
 20     appear to relate solely to cost of operations and professional fees. Each is discussed in turn.

22                   Opposition to Debtors' Motion to Temporarily Hold Funds (Garman, Docket #384);  
 23                   Mountain West Mortgage, LLC's Joinder in Oppositions to Debtors' Motion to Temporarily  
 24                   Hold Funds (Guymon, Docket # 396); Official Committee of Direct Lenders Omnibus  
 25                   Response to Individual Direct Lenders Request For Relief (Garman, docket # 406).

26                   <sup>6</sup> As discussed below, the concept of "interim" and "final" approval appears to be misleading,  
 27                   in that the Debtors have not specified any need for cash in a timeframe which would permit  
 28                   complete notice in the ordinary course to all creditors; conversely, the proposed financing  
                  assumes court approval by June 30th, creates obligations immediately upon the  
                  effectiveness of the term sheet (i.e., upon interim approval); and does not limit the Debtors'  
                  ability to draw on the line of credit pending final approval.



- 1 a. Debtors need additional sources of funds to pursue necessary collection  
 2 actions with respect to non-performing loans, given the number and  
 3 amount of non-performing loans (Financing Motion, page 8.)

4 18. To date, Debtors have not articulated, via budget or otherwise, what  
 5 expenses are associated with collection efforts. Particularly troubling is the fact that each of the  
 6 loans includes serving and management fees which are intended to cover overhead in  
 7 connection with both the servicing and collection of loans. Additional provisions exist in the  
 8 various servicing agreements with respect to out of pocket costs. See, e.g., Loan Servicing  
 9 Agreement, Exhibit 1 to Direct Lender's Motions to 1) Compel Debtor to Continue to Forward  
 10 Lender Payments to DIRECT LENDERS; and (2) to Delay or Prohibit Appraisals on  
 11 Performing Loans (Docket No. 215), at ¶¶1(d) (appraisal fees), 4 (legal fees). Further, the  
 12 Debtors' Amended Forecast does not support the purported need for outside financing, except  
 13 for payment of professional fees and costs.

- 14 b. The Debtors need liquidity to fund administrative and operational  
 15 expenses because of the irregularity of payments on the Serviced Loans  
 16 from which the Debtors' servicing fees and other contractual costs and  
 17 fees are paid (and which the Court has approved as funding sources).  
 18 (Financing Motion, page 8.)

19 19. The irregularity of payments has never been discussed before and is not  
 20 described in any detail in the Financing Motion. Indeed, no mention of this was made at prior  
 21 hearings where use of cash was an issue, and the Debtors stated unequivocally that they could  
 22 fund their operations with servicing and other fees that they are entitled to collect under  
 23 applicable agreements. Again, this statement is not supported by the Debtors' Amended  
 24 Forecast, except for the need to pay the professionals in these cases. What is the historical  
 25 irregularity, if any? How much irregularity is projected? How much funding is needed, if any,  
 26 to address this issue? The Financing Motion is void of the necessary information to evaluate  
 27 this purported ground for the financing need.

28 20. Moreover, testimony provided by the Debtors also demonstrates no need  
 for additional financing. In connection with the hearing on Debtors' "Motion for Order Under

1 11 U.S.C. §105(A), 345 and 363 Approving Debtors' Proposed Cash Management Procedures  
 2 and Interim Use of Cash in Accordance With the Proposed Cash Budget" held on May 3, 2006,  
 3 Mr. Allison testified as to the Debtors' proposed used of cash. In questioning by his own  
 4 attorney, Mr. Allison testified as follows:

5 Question [by Ms. Jarvis]: ...[I]s it your understanding that  
 6 Commercial Mortgage has rights to certain  
 7 fees that, it can be paid from the collection  
 8 account?

9 Answer [by Mr. Allison]: That is correct.

10 Question: And...the cash management motion, does  
 11 that propose only to transfer those  
 12 fees...from the collection account to the  
 13 operating account for the debtors' use?

14 Answer: **That is correct. What we're proposing to**  
 15 **do is to use the loan-servicing fee as**  
 16 **servicing agent to administer this estate,**  
 17 **and those - - we're entitled to several**  
 18 **categories of fees that would be - - that**  
 19 **would be part of our - - what we plan to**  
 20 **administer the estate with.**

21 ...

22 **So...we'd use those fees along with any**  
 23 **fees that we took which are late fees or if**  
 24 **we have to renew a - - transaction. Those**  
 25 **are the fees that we would contemplate**  
 26 **using to - - to operate this estate.**

27 Question: ...you are not proposing to move or transfer  
 28 any other amounts in the collection  
 accounts?

Answer: No, your honor - - no, Ms. Jarvis. My intent  
 is to keep those moneys segregated as I  
 become successful and bring back  
 delinquent interest and bring principal back  
 into the estate. We're segregating and  
 identifying it by loan that's collected.

1 Id. at pages 42-43.<sup>7</sup>

2 This position was reiterated under questioning by Mr. Gordon:

3 Question: Mr. Allison, I appreciate the effort that was done in the  
4 last couple weeks with regard to the budget. It is  
5 substantially different that what was presented and much  
6 more defined.

7 I just wanted to make - - understand very clearly with  
8 regard to the budget that you are basically estimating for  
9 the 13 weeks that based on your projected income versus  
10 the projected expenses for the administrative period, that  
11 you're going to show a net of, approximately, \$123,000.  
12 That's what you're projecting.

13 Answer: That's correct.

14 Question: So you're showing that the operations during this period of  
15 time from an administrative standpoint will be positive  
16 and not negative.

17 Answer: That's correct.

18 Question: Okay. And with regard to the estimated-service fees, am I  
19 correct that when you testified, you stated those were from  
20 performing loans only that you anticipated that would be  
21 received?

22 Answer: That's correct.

23 Id. at page 74, lines 9-24.

24 e. To have the necessary funds to permit the Debtors to accomplish the  
25 various tasks that are necessary to analyze and safeguard the interests of  
26 all Direct Lenders (including the interests of the Funds as Direct Lenders)  
27 and Fund Members. (Financing Motion, Page 8)

28 21. Again, the Debtors have not demonstrated the need for such funding, nor  
articulated the "various tasks" to be performed for which the servicing fees and cash on hand is

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<sup>7</sup> The First Trust Deed Committee requests that the Court take judicial notice of that transcript, which appears as Docket No. 431 in this proceeding.

insufficient. Further, the Debtors have done no analysis of the impact of the proposed financing upon ultimate distribution to investors and other creditors. The First Trust Deed Committee suggests that it is inappropriate to incur massive loan origination, due diligence, and financing charges in order to obtain "liquidity" for payment of administrative expenses, i.e., payment of professionals in this case. Here, as in any case, the professionals appointed by the Court undertake the risk that, if the case is unsuccessful, there will be insufficient funds to pay their fees. "Chapter 11 cases which lack viable chances of reorganization may place the fees of counsel at risk." In re Berg, 268 B.R. 250, 260 (Bankr. D. Mont. 2001), citing, e.g., In re Mflex Corp., 172 B.R. 854, 857 (Bankr. W.D. Tex. 1994); In re Offield, 128 B.R. 548, 550 (Bankr. W.D. Mo. 1991); In re Lederman Enterprises, Inc., 143 B.R. 772, 775 (D.C. D. Colo. 1992). Also, as discussed above, Mr. Allison's testimony as well as the most recent budget filed with this Court do not indicate the need for financing to cover operational expenses.

**C. The Debtors' Proposal to Borrow Money to Fund Additional Loans is Unsupported, Premature, and Contrary to the Interests of the Creditors and Investors.**

22. The Debtors offer two additional grounds purportedly justifying the financing request:

- i. The Debtors need a source of funding for the Shortfall Loans to complete the construction projects, but only if Debtors determine that additional funding is necessary or appropriate to preserve or enhance the value of the underlying collateral for the Serviced Loans for the Direct Lenders, the Funds, the Fund Members, and USACM, and Court approval is obtained after specific notice to all parties in interest. (Financing Motion, page 8.); and
- ii. To provide USACM the ability to originate new loans for the purpose of generating income for payment to the Debtors' creditors and to assist the Debtors in their efforts to reorganize and maintain viable and ongoing business operations. (Financing Motion, page 9.)

23. The Debtors indicate that they are not at this time seeking court approval for additional loan originations. However, the term sheet attached to the Financing Motion

1 indicates that, upon approval, Capital Source will have a "right of first offer" on all future  
 2 funding obligations. Further, and more troubling, the term sheet provides that "each Additional  
 3 DIP Loan will prime prior advances under the existing loan or loans..." The term sheet further  
 4 provides that "[t]he Additional DIP Loans will be term loans, with origination fees of 1.50% of  
 5 the face amount, and interest rates of no more than allowed LIBOR plus 7.50%, with all of  
 6 Lender's expenses to be reimbursed and other terms and conditions as customary for loans of  
 7 similar risk profile and tenor." Thus, a close review of the term sheet illustrates that Debtors are  
 8 proposing that they offer Capital Source the opportunity to make additional loans to existing  
 9 borrowers, with such loans to prime the loans of the Direct Lenders and the Funds. As  
 10 discussed below, such priming loans are clearly inappropriate.

11 24. Further, the pre-approval of such future financing terms is sought without  
 12 any disclosure as to the specifics of such additional loans, and without any discussion of  
 13 Debtors' efforts to find substitute lenders to make such loans without the necessity of priming  
 14 existing loans. The First Trust Deed Committee believes that, as to such projects "in process",  
 15 the Debtors should explore the viability of exit financing from third party lenders which would  
 16 completely pay off existing loan facilities and move the loans to other lenders who have the  
 17 ability to continue to fund.

18 25. The Debtor<sup>8</sup> has not attempted to satisfy any of the Section 364(d)  
 19 requirements. Indeed, the Debtors do not identify what properties will be the subject of such  
 20 loans, nor the value of the underlying collateral.<sup>9</sup> The Debtors do not identify the current  
 21 amount of debt on the properties to be encumbered by "priming loans," nor specify how existing  
 22 loans will be repaid. See, supra, page 4 (Bankruptcy Code section 364(d) standard). However,  
 23  
 24

25 <sup>8</sup> The term "Debtor" is utilized on the supposition that the new loans would be made by  
 USACMC, although this is not specified in the Financing Motion.

26 <sup>9</sup> This Court previously approved the hiring of an appraisal firm to conduct appraisals on all  
 27 of the collateral for the various loans serviced by USACMC. While a significant number of  
 28 those appraisals should be in hand by now, only five such appraisals have been provided by  
 the Debtors in response to information requests from the First Trust Deed Committee.

1 approval of the current Term Sheet creates substantive rights in the proposed lender with respect  
 2 to such future transactions, including the right to repayment of all expenses and due diligence  
 3 fees in connection with such requests. Further, the purported "need" to fund additional  
 4 construction loans is utilized by the Debtors as a justification for the current funding proposal.  
 5 Logically, if the Debtors cannot satisfy the requirements for such borrowing, the Court should  
 6 neither pre-approve related expenses nor permit the Debtors to bootstrap the funding request by  
 7 reference to some future, unspecified, and unjustified "need" for further borrowings for the  
 8 purpose of making new "priming" loans.

9           26. Pursuant to section 364(d) of the Bankruptcy Code, the Debtors have the  
 10 affirmative burden of proving adequate protection of the existing liens. However, the Debtors  
 11 make no effort to meet their burden of demonstrating adequate protection of the interests of  
 12 existing lenders. See, e.g., In re Swedeland Dev. Group, Inc., 16 F.3d 552, 564 (3rd Cir. 1994).  
 13 In that case, the debtor requested that the court approve super priority financing to complete  
 14 construction, arguing that, although the secured creditor was currently undersecured, a  
 15 combination of turnover of cash, third party guaranties, and increased valuation through the  
 16 construction would suffice to afford adequate protection. The court rejected each argument in  
 17 turn. First, the court noted that offering payments from collateral already pledged to the  
 18 existing creditor adds nothing to compensate for the loss of priority. Second, the court found  
 19 that a third party guaranty was insufficient under the facts of that case, both because of the  
 20 existing guaranty and because the value of the guaranty, i.e. the net worth of the proposed  
 21 guarantor, was not demonstrated. Finally, the court held that projections of future value based  
 22 upon construction was not sufficient to adequately protect the creditor, where there was no  
 23 demonstration that any increase in value would be sufficient to compensate for the loss caused  
 24 by the priming lien.

25           27. Similarly, in In re Mosello, 296 B.R. 277 (Bankr. S.D.N.Y.) aff'd, 104  
 26 F.3d 352 (2d Cir. 1996), the debtor, a developer, argued that the loan would result in an increase  
 27 in value sufficient to compensate for the loss of priority to existing lenders. The court rejected  
 28 the argument, finding that the argued increase in value was too speculative to meet the burden



1 of demonstrating adequate protection. The court noted that the debtor's proposal placed all of  
 2 the risk of error in the debtor's projections on the existing lenders, who had rejected the debtor's  
 3 proposal. See also, In re James River Assoc's, 148 B.R. 790, 797 (E.D. Va. 1992), ( rejecting  
 4 the Debtors' proposal for a priming lien both because there was a lack of equity cushion for  
 5 existing lenders and because the proposed repayment structure was speculative); In re Phoenix  
 6 Steel Corp., 39 B.R. 218, 233 (D.C.D. Delaware 1984), (finding that the debtor had failed to  
 7 meet its burden of proving adequate protection and denied the request for a priming lien.)

8           28. In this case, the speculative nature of the proposed transactions is  
 9 multifold. The Debtors do not identify the collateral; the existing lenders; the existing loans;  
 10 the status of payments on existing loans; the amount to be funded in new, priming, loans; the  
 11 source of repayment of both existing and new loans; nor the need for such additional financing.  
 12 Further, the Debtors make no effort to demonstrate that they have explored refinancing of  
 13 existing obligations (either through Capital Source or through other lenders) in order to pay off  
 14 current lenders without incurring additional risk and delay. For all of these reasons, any  
 15 consideration of future, "priming" loans (including any "first right of refusal" or similar right;  
 16 any agreement to pay fees or expenses incurred in connection with future loans; and any  
 17 justification of the current Financing Motion by reference to such future loans) is premature and  
 18 should be rejected by this Court.

19 **D. There is No Evidence that the Proposed DIP Financing Terms and Conditions are**  
 20 **Fair and Reasonable.**

21           29. The Proposed Financing Motion is supported by no evidence that the  
 22 terms and conditions of the financing are fair and reasonable. Nor is there any evidence that the  
 23 financing was adequately marketed. Until ample evidence is provided that demonstrates that  
 24 the terms and conditions of the proposed financing are fair and reasonable and the best available  
 25 in the current market, the Financing Motion should be denied.

26           In the event the Court elects to consider approval of the proposed financing at  
 27 this time, there are certain provision in the Term Sheet that the First Trust Deed Committee  
 28

1 believes must be revised or eliminated as well as certain essential terms that are missing and  
2 must be added to the Term Sheet, as follows:

3 1. Interest and Fees: The Term Sheet provides for an Exit Fee equal to  
4 0.50% of the Revolver Maximum Loan Amount upon maturity. It is neither necessary nor  
5 reasonable to pay the proposed Exit Fee.

6 2. ROFO for Additional Loans: The Term Sheet provides the lender with a  
7 right of first refusal for up to \$68M of additional funds for additional loans to borrowers at  
8 specified terms. It is premature and overreaching to provide the right of first refusal for this  
9 funding. There may be other lenders willing to make available more favorable financing.  
10 Further, it may be in the estates' best interest to sell these loans to a third party.

11 3. Mandatory Prepayments: All asset disposition proceeds among other  
12 proceeds must be paid to the lender to satisfy obligations under the proposed financing. In these  
13 cases, the mandatory payment programs are fundamentally unfair; for example, if a loan of  
14 100% made by the First Trust Deed Fund is paid off under the Term Sheet, all proceeds of such  
15 loan must be paid out to satisfy the obligations to the lender under the financing, with such  
16 payment thereby benefiting the estates as a whole. On the other had, the First Trust Deed Fund  
17 will only receive a small, pro rata benefit of the payment which it otherwise would have  
18 received in full.

19 4. Collateral and Security: The Term Sheet provides for a host of collateral  
20 for the lender. The lender should not receive avoiding power causes of action and intra-  
21 company receivables. Further there is no carve out for investor funds in the Collection Account  
22 and the Investor Account. In addition, there is no detail in the proposed fee carve out for  
23 professional fees and costs.

24 5. Closing Conditions: Among many of the closing conditions are the lock  
25 box requirement and cross default requirement. The lock box should not include investor  
26 interest or principal. The cross default provision should not permit the lender to accelerate or  
27 exercise other remedies merely because certain of the portfolio includes non-performing loans  
28 including performing loans that later are deemed nonperforming.

6. Costs and Expenses: The Term Sheet provides that due diligence fees and costs will be back-ended. Rather than provide for these costs up front because the Court has refused to approve them, these charges have been back-ended and should not be allowed.

The Term Sheet also includes a negotiation exclusivity provision. Given the facts that the Debtors are in chapter 11 and, moreover, that Debtors are negotiating with another potential lender now, the exclusivity provision should be eliminated.

7. Portfolio Right of First Refusal: The Term Sheet gives the lender the exclusive right of 45 days from closing to serve as the stalking horse with bid protections for a purchase of the portfolio. The lender should not automatically become the stalking horse. Rather a proposed purchaser with the proposal with best terms and conditions should be stalking horse.

8. Additional Provisions: The Term Sheet does not include certain essential provisions that must be included in any final version:

a. Surcharge - any final financing agreement must include some mechanism to charge back costs of administration pro rata to the Direct Lenders. The Funds should not be required specifically to carry the costs of these cases.

b. Reporting - The Debtors must be required to provide weekly reports to the Committees including a weekly cash report that shows budget to actual for the prior week.

**E. The Debtors' Request for Approval of the Financing Motion on Shortened Time and Limited Notice is Inappropriate**

30. Finally, the Debtors' request to hear this motion on approximately seven business days' notice is not well taken. This Court previously cautioned Debtors' counsel on this very subject, in connection with a prior funding request involving another prospective lender, saying: "[Y]ou know what's going to happen? Everybody's going to be here screaming[.] I have to have time to look at it, and it would have to be continued, anyway..." Transcript of hearing. May 3, 2006, at p. 147. In discussing a proposal to preapprove a \$150,000 due diligence fee (versus this motion, seeking unlimited due diligence reimbursement

1 and additional fees in excess of \$150,000), the Court stated: "\$150,000 is no small change in  
 2 this case." Id. at 148. Speaking generically, the Court cautioned: "Things on shortened time  
 3 don't save time. I've discovered that 18 years now. Every time I have something on shortened  
 4 time, it always has to get continued.... People, you need time to prepare adequately. So I'm  
 5 rarely going to grant orders shortening time." Id. at 138-39.

6 31. Despite this Court's warning, Debtors' counsel filed **five separate**  
 7 motions late in the day on June 9 (the last possible date for requesting an order shortening time  
 8 on ten days' notice for the June 21 calendar). The First Trust Deed Committee counsel  
 9 consented to the hearings on shortened time on certain of the motions, but expressly  
 10 disapproved of the request with respect to the Financing Motion. The purported justification for  
 11 the request for Order Shortening Time, as set forth in the application and affidavit of Lenard  
 12 Schwartzter, is that: "The current budget (with four Official committees) reflects that  
 13 administrative expenses will exceed loan servicing fees by mid-July, 2006." However, this does  
 14 not appear to be the case. First, the Amended Forecast includes the starting cash balance of  
 15 approximately \$1.4 million, which provides more than enough when combined with servicing  
 16 fee collections to cover the alleged extra funding requirements in the short term. Secondly, a  
 17 part of this need is driven by the Debtors filing (originally on shortened time) a request for  
 18 interim compensation procedures. That request, which fails to set forth any proposal for the  
 19 allocation and payment from the Debtors' separate estates of the fees incurred on an estate-by-  
 20 estate basis, nevertheless requests monthly fee payments. The urgency of the financing motion  
 21 may solely be to obtain payment of professional fees in shorter course than as provided by 11  
 22 U.S.C. §331. Payment of professional fees should not form the basis for the financing urgency,  
 23 particularly when there is no similar urgency in resuming distributions to investors.

24 **F. The Debtors' Request for "Interim" Approval of the Financing Motion is**  
 25 **Unsupported and Inconsistent with Fed. R. Bankr.P. 4001(c).**

26 32. Fed.R.Bankr.P. 4001(c)(2) provides that, as to any financing motion  
 27 heard on less than 15 days' notice, the Court can grant interim approval "only to the extent  
 28

1 necessary to avoid immediate and irreparable harm to the estate pending a final hearing."  
 2 Debtors do not attempt to demonstrate the extent to which such interim approval is necessary  
 3 under this standard. As discussed above, the only evidence of the Debtors' cash needs is the  
 4 Amended Forecast. However, that Amended Forecast indicates that the Debtors will have  
 5 sufficient cash on hand through the next Omnibus hearing date.

6 33. Additionally, the term sheet attached to the Financing Motion requires  
 7 court approval by June 30. Apparently, the Debtors seeks to approve all of the Lender's fees  
 8 and expenses at the "Interim" hearing. (The total of such amounts is not specified and, in fact,  
 9 is not subject to a cap.) It is submitted that the Debtors cannot demonstrate a need to approve  
 10 such expenses on an "Interim" basis, when no justification within the scope of Rule 4001(c)(2)  
 11 for the "Interim Financing" has been shown.

### 12 III. CONCLUSION

13 34. For the reasons stated above, the First Trust Deed Committee respectfully  
 14 requests that the Financing Motion be denied, and that the Court issue such other relief as may  
 15 be just and proper.

16 DATED this 19th day of June, 2006.

17 /s/ Eve H. Karasik

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